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SUBJECT: YEMEN: AMBITIOUS POWER GENERATION PLANS HAUNTED BY PAST FAILURES

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¶1. (SBU) SUMMARY. Yemen's national electricity grid serves only a small fraction of the population and bypasses the industrial sector completely. Realizing that maintaining oil product-powered plants is fiscally unsustainable, the ROYG plans to build three natural gas-fired power plants. The tendering and project construction fiasco that defined Yemen's first such plant, the Iranian-contracted Marib 1 power station, does not bode well for the ROYG's ability to competently expand the national grid and thus attract much-needed foreign direct investment (FDI). END SUMMARY.

POWER SECTOR WEAK AND INEFFICIENT

¶2. (U) Yemen's power sector has long been a fiscal burden, an obstacle to large-scale investment, and a significant source of corruption in the tendering process. The ROYG provides electricity for a mere 15 percent of rural residents, who account for two-thirds of the country's total population (23 million). The 90 percent of urban residents in major cities who are connected to the national grid suffer from daily blackouts and uneven transmission to their home appliances. The Ministry of Electricity's entire power capacity is only 1,000 Megawatts (MW), generated by a mix of heavy fuel oil (HFO), light fuel oil (LFO), and diesel plants spread across the country, according to ministry officials. (Note: In the U.S. 1,000 MW powers approximately 1 million homes. In Yemen, by contrast, 1,000 MW is supposed to cover 3.2 million homes, numerous industrial plants, and operations at three major ports. End Note.)

¶3. (U) According to Saad Sabrah, chairman of a new ROYG agency that buys land for foreign investors, the lack of access to electricity scares away potential investors who could build factories and other labor-intensive projects in which Yemen, a poor country with millions of unemployed youth, should have a comparative advantage over its GCC neighbors. Wheat and sugar refineries, upstream oil and gas facilities, cement plants, and other large-scale industrial projects in Yemen all rely on their own diesel-powered generators for electricity, a significant capital cost that cuts into firms' profit margins, according to Khaled Mustafa, Chairman of the Sanaa Chamber of Commerce. Future projects - desalination plants, cement plants, tourist resorts, and manufacturing facilities - will materialize only if the ROYG's power generation capacity is expanded significantly.

SWITCHING TO NATURAL GAS

¶4. (U) The ROYG realized over a decade ago that natural

gas-fired plants were more efficient than those running on HFO or diesel, but so far only one, the Marib 1 plant, is near completion, with three more plants in various stages of the tendering process. The Public Electricity Corporation (PEC), Yemen's sole electricity provider and a perpetually unprofitable enterprise, spends approximately USD 700 million on HFO alone for power generation every year, a fiscal burden made worse by the opportunity cost of not using natural gas, which Yemen has in abundance and which would be provided free of charge to the PEC. The World Bank estimates that the ROYG could save on the purchase of 800 million barrels of crude oil over the next 30 years by switching the power sector to natural gas. The ROYG has largely recognized the fiscal and environmental benefits of conversion, despite having dedicated 9.7 trillion cubic feet (TCF) of Yemen's 11.8 TCF of certified natural gas reserves for export as Liquefied Natural Gas (LNG) (REF A) rather than domestic power sector use.

¶5. (SBU) The ROYG has plans for three additional natural gas-fired plants -- Marib II (600 MW), Marib III (300 MW), and Mabar I (projected capacity not yet announced). The financing for these projects has yet to be determined, but the Saudi Fund, the Islamic Development Bank, and the Government of Oman have all pledged support, according to Asaad al-Ashwal, a project director at the Ministry of Electricity. The ministry has been unable to attract major companies to the tendering process, however, with Siemens having pulled out most recently. Eight bidders, from Russia, South Korea, Spain, and India, have pre-qualified, but ministry officials privately fear a repeat of the oft-maligned Marib 1 plant tender that went to a technically

incompetent Iranian firm. Dubai-based General Electric (GE) executives told Econoff that, based on GE's previous experience in Yemen, GE and other major international companies would steer clear of the ROYG tendering process, which they described as "corrupt at every step of the way."

THE MARIB 1 PLANT FIASCO

¶6. (U) The tendering and execution of the 440 MW Marib 1 power plant project, now in its seventh year, is an example of the ROYG's inability to attract technically competent bidders to major infrastructure projects (REF B). In 2002, the Ministry of Electricity awarded the Marib 1 tender to an Iranian firm that later was found to have had little actual experience in power station construction or management, Deputy Minister of Electricity Ahmed al-Aini told Econoff. The Marib 1 project manager, Khaled Rashid, denied press reports that the Iranian company had paid a USD 60 million fine to the ROYG for violations of its contract for supplying substandard transformers to the plant. "At this point, with all our problems with the Iranians, what's the purpose of punishing the company) we just want them to finish and get out," Rashid told Econoff. The technical delays at Marib 1 caused by the Iranian firm have cost the ROYG hundreds of millions of USD in savings from switching from comparatively expensive diesel to natural gas, according to Deputy Finance Minister Jalal Yaqoub.

COMMENT

¶7. (SBU) Embassy contacts across the Yemeni energy sector say that the ROYG's management of the power sector has only worsened since the beginning of the Marib power plant fiasco. Requests for kickbacks at every stage of the tendering process, nepotism in the Ministry of Electricity project management offices, and the lack of a strategic power sector plan still carry the day. Yemen will not attract FDI into energy-intensive projects until it dramatically expands the national grid capacity. The ROYG's plan to build three additional natural gas-fired plants would accomplish this

goal, but its current operating style ensures that the road will be fraught with mismanagement, technical delays, and corruption at every turn. END COMMENT.
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